

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
August 15, 2003
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Karl Polen, Chairman, Arizona State Retirement System Board, called the meeting to order at 8:35 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call, Opening Remarks

Present: Mr. Karl Polen, Chairman (Teleconferencing)
Mr. Norman Miller, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Keith Meredith
Mr. Carl Tenney
Mr. Lawrence Trachtenberg (Arrived at 8:45 a.m.)
Mr. Steven Zeman

Excused: Dr. Chuck Essigs

A quorum was present for the purpose of conducting business.

The meeting was turned over to Mr. Norman Miller, Vice-Chairman.

2. Approval of Minutes of the June 20, 2003, Regular Meeting and Executive Session of the ASRS Board

Motion: Ms. Charlotte Borchert moved to approve the minutes of the June 20, 2003 regular meeting and the June 20, 2003 executive session summary of the ASRS Board.

Mr. Jim Bruner seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

3. Approval of Consent Schedule

Motion: Dr. Keith Meredith moved to approve Refunds, Death Benefits, Retirements, System Transfers, and the Applications and Agreements with:

- Excel Education Centers Chino Valley, LLC
- Excel Education Centers San Carlos, LLC
- Excel Education Centers Prescott Valley, LLC
- Excel Education Centers Flagstaff, LLC
- Excel Education Centers Cottonwood, LLC
- Excel Education Centers Prescott, LLC
- Excel Education Centers Fort Mohave, LLC
- Town of Oro Valley
- Canyon Rose Academy
- Pinnacle Education Freedom Academy, LLC
- Pinnacle Education Day Star Academy, LLC
- Pinnacle Education Westmark Chandler Blvd., LLC
- Pinnacle Education Kino Academy, LLC
- Pinnacle Education Pinal, LLC
- Pinnacle Education East Valley No. 1, LLC
- Pinnacle Education East Valley No. 2, LLC
- Pinnacle Education Westmark Arizona Ave., LLC

and to renew the contract with Maximus Inc.

Ms. Charlotte Borchert seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding Adoption of the First Amendment to the Supplemental Retirement Savings Plan

Per Mr. Paul Matson, Director, these amendments are technical changes with respect to participation, contributions and compensation. The staff will bring a full packet to the Board, at a future meeting, which will include all changes to the Supplemental Retirement Savings Plan document. The Private Letter Ruling has not yet been received, however, from the IRS. The amendments do need to be approved by the Board before the ASRS can proceed any further with this plan.

Motion: Mr. Jim Bruner moved to adopt the First Amendment to the Supplemental Retirement Savings Plan and to authorize and direct the Director of the ASRS to execute such First Amendment for and on behalf of the Board.

Dr. Keith Meredith seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding Draft System Rules and Actuarial Methodology

Mr. Richard Stephenson, Deputy Director, External Affairs, explained that the Rules Committee is recommending that the Board adopt the actuarial methodology regarding the 95% to 105% range. This actuarial methodology provides for a funded status range (95% to 105%) within which no additions to or subtractions from the non-guaranteed portions of System member's accounts or benefits be made.

Ms. Borchert added that this affects the System members only. This affects the portion of the pension that is not guaranteed as well as the 13th check.

Motion: Ms. Charlotte Borchert, Rules Committee Chair, moved to adopt an actuarial methodology for the "System" as follows:

"If the actuarially determined funded status of the System as of June 30 of each year is between 95% and 105% inclusive, no additions to or subtractions from the non-guaranteed portions of a 'System' member's account or benefit will be made."

Dr. Keith Meredith seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Mr. Lawrence Trachtenberg joined the meeting at 8:45 a.m.

6. Presentation, Discussion and Appropriate Action Regarding Renewal of Emergency Rulemaking for R2-8-123, Actuarial Assumptions and Actuarial Values of Assets for the Defined Benefit Plan

Ms. Borchert explained that the Committee is requesting that the Board extend the renewal of the Emergency Rulemaking process because the Governor's Regulatory Review Council (GRRC) will likely not hear this rule until approximately October 2003, and the existing Emergency Rule will have expired.

Motion: Ms. Charlotte Borchert moved to approve the renewal of the Emergency Rulemaking for R2-8-123.

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

7. Presentation, Discussion and Appropriate Action Regarding Final Rulemaking for R2-8-123, Actuarial Assumptions and Actuarial Values of Assets for the Defined Benefit Plan

To make Emergency Rule R2-8-123 permanent, the Board approved the Proposed Rulemaking at the April 18, 2003 meeting and the Proposed Rulemaking was filed with the Secretary of State on May 16, 2003. The close of record for comments on the Proposed Rulemaking was July 3, 2003. The Proposed Rulemaking was also sent to a Governor's Regulatory Review Council staff attorney for a courtesy review and technical amendments were made to the proposed rule based on the staff attorney's suggestions. The final rule looks somewhat different than the proposed rule because a number of definitions were added and it was reorganized, however, there were no substantial changes made to the rule that would necessitate a Supplemental Proposed Rulemaking.

Motion: Ms. Charlotte Borchert moved that the Board approve the Final Rulemaking for R2-8-123.

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding the ASRS Asset Allocation

Mr. Gary Dokes, Acting Chief Investment Officer, presented the recent asset allocation study conducted by IMD and Mercer Investment Consulting. This study emphasized the point that determining the ASRS' asset allocation policy is the most important decision that will be made in managing ASRS' investment portfolio. This is important because asset allocation is responsible for 80% to 90% of total Fund return. Investment manager selection, manager's security selection and market timing decisions account for a relatively small portion of ASRS' total Fund return.

The asset allocation study involved the review and subsequent recommendation associated with four major components:

1. Broad Asset Class Allocation
2. Sub-Asset Class Allocation
3. Asset Class Performance Benchmarks
4. Passive/Active Targets.

Mr. Dokes explained that one of the first components of an asset allocation study was to review the long term capital market assumptions for various asset classes, i.e. their expected returns and the expected standard deviation of returns. The following assumptions were provided by Mercer Investment Consulting:

Asset Class	Expected Return Annualized	Standard Deviation Annualized
U.S. Equity	8.5%	18.6%
International Equity	8.5%	21.9%
U.S. Fixed Income	4.5%	6.3%
Real Estate	7.7%	13.5%

Given these capital market assumptions, the following lists the existing and proposed broad asset class allocations :

Asset Class	Current	Proposed
U.S. Equity	53% +/- 5%	53% +/- 5%
International Equity	17% +/- 3%	15% +/- 5%
U.S. Fixed Income	30% +/- 5%	26% +/- 5%
Real Estate	---	6% +/- 2%
Expected Return	7.30%	7.41%
Standard Deviation	13.31%	13.35%
Sharpe Ratio*	0.36	0.37

*Measure of return per unit of risk

The purpose of the sub-asset allocation part of the study was to determine the appropriate allocation of U.S. Equity portfolios among large, mid, and small-cap sub asset classes. The lists the existing and proposed equity sub-asset class allocations:

	Current	Proposed
U.S. Large-Cap Equity (LC)	45% +/-5.0%	43% +/-5.0%
U.S. Mid-Cap Equity (MC)	4% +/-1.5%	5% +/-1.5%
U.S. Small-Cap Equity (SC)	4% +/-1.5%	5% +/-1.5%

Asset class benchmarks are used to assess the performance of ASRS' internally and externally managed portfolios. The ASRS currently uses the S&P 500 and S&P 400 for large- and mid-cap equity, respectively and uses the Russell 2000 Index for small-cap equities. For international equities the ASRS uses the MSCI EAFE (Europe, Australasia, Far East) Index, which is the leading benchmark for non-U.S. equity investing. The ASRS uses the Lehman Brothers Aggregate Index as a benchmark for the U.S. fixed income market. There is no recommended change to these benchmarks at this time.

Passive/Active targets determine the appropriate mix between passive and active portfolios within each sub-asset class. The following table shows the current passive allocation and proposed allocation for ASRS' sub-asset classes. The sole proposed recommended change is in the U.S. mid-cap equity sub-asset class. The rationale is consistent with Mercer and ASRS analysis relative to fee-adjusted performance universe data and the ASRS' historical performance experience with mid-cap managers.

Asset Class	Current Passive Allocation		Proposed
	Actual*	Target	
U.S. Large Cap Equity	79%	75% +/-10%	75% +/-10%
U.S. Mid Cap Equity	52%	37.5% +/-20%	45% +/-20%
U.S. Small Cap Equity	35%	30% +/-20%	30% +/-20%
U.S. Fixed Income	74%	80% +/-10%	80% +/-10%
International Equity	42%	30% +/-20%	30% +/-20%

*Actuals as of 5/31/03

The new asset allocation policy will be implemented effective October 1, 2003. Funding of a real estate portfolio will occur as market conditions allow or over the next 12 to 18 months. The IRC discussed this asset allocation study and agreed to recommend the above-mentioned changes to the ASRS Board.

Motion: Mr. Jim Bruner moved to approve the IRC recommendations with respect to the following broad asset allocation target/ranges:

Asset Class	Targets with Ranges	
	Current	Proposed
U.S. Equity	53% +/- 5%	53% +/-5%
International Equity	17% +/- 3%	15% +/-5%
U.S. Fixed Income	30% +/- 5%	26% +/-5%
Real Estate		6% +/-2%

Mr. Carl Tenney seconded the motion.

Motion: Mr. Jim Bruner moved to approve the IRC recommendation to retain the existing investment management benchmarks:

- S&P 500 for U.S. Large-Cap Equity
- S&P 400 for U.S. Mid-Cap Equity
- Russell 2000 for U.S. Small-Cap Equity
- MSCI EAFE for International Equity
- Lehman Brothers Aggregate for U.S. Fixed Income

Ms. Charlotte Borchert seconded the motion.

Motion: Mr. Jim Bruner moved to approve the following sub-asset class allocation targets:

	Current	Proposed
U.S. Large-Cap Equity	45% +/-5.0%	43% +/-5.0%
U.S. Mid-Cap Equity	4% +/-1.5%	5% +/-1.5%
U.S. Small-Cap Equity	4% +/-1.5%	5% +/-1.5%

Ms. Charlotte Borchert seconded the motion.

Motion: Mr. Jim Bruner moved to approve the following IRC recommendation with respect to the ASRS' passive allocation targets:

Asset Class	Targets with Ranges	
	Current	Proposed
U.S. Large-Cap Equity	75% +/-10%	75% +/-10%
U.S. Mid-Cap Equity	37.5% +/-20%	45% +/-20%
U.S. Small-Cap Equity	30% +/-20%	30% +/-20%
U.S. Fixed Income	80% +/-10%	80% +/-10%
International Equity	30% +/-20%	30% +/-20%

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

9. Total fund Performance Overview for Quarter Ending 6/30/03

Mr. Terry Dennison, Principal, Mercer Investment Consulting, presented an economic and market review and reported on the Total Fund for the period ending June 30, 2003.

	Quarter	1 Year	3 Years	5 Years	Inception
Total Fund	13.0	2.4	-4.3	2.4	10.7
Benchmark*	12.1	2.6	-5.0	1.0	8.8
RM Public Funds Median	11.6	3.4	-3.1	2.7	-

*1/1/89-12/31/91 - 60% S&P 500/40% LB Aggregate
1/1/92-12/31/94 - 50% S&P 500/40% LB Aggregate/10% EAFE,
1/1/95-6/30/97 - 45% S&P 500/40% LB Aggregate/15%/EAFE,
7/1/97-12/31/99 - 50% S&P 500/35% LB Aggregate/15% EAFE,
1/1/00-Present - 53% S&P 500/30% LB Aggregate/17% EAFE.

10. Domestic Fixed Income Managers Reporting for quarter Ending 6/30/03

Mr. Gary Dokes, Acting Chief Investment Officer, and Ms. Catherine Budd-Ulozas, Fixed Income Portfolio Manager, presented the performance for the ASRS F1 and F2 portfolios.

	Quarter	1 Year	Inception (*)
F1 Net Return	2.40	10.93	7.65
LB Agg Index	2.50	10.40	7.65
Value Added	-0.10	0.53	0.00

*From 3/31/98 (annualized)

	Quarter	1 Year	Inception (*)
F2 Net Return	2.34	10.70	9.89
LB Agg Index	2.50	10.40	9.85
Value Added	-0.16	0.30	0.04

*From 9/31/00 (annualized)

Mr. Robert Capaldi, CFA, Managing Director, presented for BlackRock Asset Management.

	Quarter	1 Year	Inception*
BlackRock	2.68	11.03	7.49
LB Agg Index	2.50	10.40	7.27
Value Added	0.18	0.63	0.22

*From 11/30/98 (annualized)

Mr. E. Luke Farrell, Client Portfolio Manager, presented for JP Morgan Fleming.

	Quarter	YTD June*	1 Year	3 Years	5 Years	Inception*
JP Morgan	2.74	4.36	11.12	10.43	7.76	8.62
LB Agg Index	2.50	3.92	10.40	10.08	7.54	8.53
Value Added	0.24	0.44	0.72	0.35	0.22	0.09

*Returns less than one year are not annualized.

Inception date: 6/30/87

11. Director's Report and Budget Update

Mr. Paul Matson, Director, provided an update pertaining to the ASRS budget. The budget is approximately 5% less than the budget for the period ending June 30, 2003, and approximately 19% less than requested. As a result, ASRS staff is in the process of determining what cutbacks can be made and reviewing expenses for the period ending June 30, 2003, in order to save money from this point forward.

The main issue pertains to the ASRS operating budget. There is approximately \$1.2 million less in the ASRS operating budget than last year (June 30, 2003). Executive and Senior Management staff have been meeting to consider various options to reduce or defer operating expenses. While final decisions have not been made, Mr. Matson is optimistic of the staff's ability to reconcile expenditures to the ASRS' appropriations. An expenditure plan should be completed in approximately ten days.

Mr. Jim Bruner inquired as to the status of the Board Governance. Mr. Matson informed Mr. Bruner and the Board that Mercer Investment Consulting is currently sending out a survey to effectively managed organizations. This survey has been responded to by approximately 75% of the respondents. Mr. Matson expects to have all responses and final documents in within approximately 14 days. Mr. Bruner expressed an interest in seeing the raw data received from these respondents. Additionally, Mr. Bruner requested an updated timeline on where the ASRS is with respect to this process.

12. Board Requests for Agenda Items

None.

13. Call to the Public

Mr. Bill Peltier inquired whether or not the ASRS anticipates the contribution rates changing with respect to agenda item #5 and #6.

14. The next ASRS Board meeting is scheduled for Friday, September 19, 2003, at 9:30 a.m., at the Little America Hotel, in Flagstaff, Arizona.

15. Adjournment of the ASRS Board.

Mr. Norman Miller, Vice Chairman, adjourned the August 15, 2003, meeting of the ASRS Board at 10:57 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Marina Chaves, Secretary

Date

Paul Matson, Director

Date